

FOMC Briefing
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January 30, 1984

The setting of long-run targets for 1984 involves three principal issues--first, should the ranges continue to be reduced; second, if so, by how much, and how distributed among the aggregates; and, third, should more weight be given to M1 in presentation of the ranges and in policy implementation.

With regard to reductions in the ranges, the ranges for 1983 were well above those likely to be consistent with reasonable price stability, so that reductions from them would seem to be called for if price stability is a long-term goal of policy and the public is to be convinced of it. Moreover, some reduction is not likely to impede continuation of expansion in real economic activity at a satisfactory pace. The natural and desirable slowing of real growth in the second year of economic recovery would generally be consistent with slower money growth, and perhaps particularly so in current circumstances when real growth will in any event be sustained by a further rise in fiscal stimulus.

The second issue--how much of a reduction and how distributed among the aggregates--seems a bit more difficult. The extent of reduction depends in part on a judgmental balancing of how much added restraint against prices can be exerted--given the existing degree of wage and price flexibility in the economy--without excessively slowing the rate of economic expression. The 1/2 point reductions in the tentatively adopted ranges for the broad monetary aggregates and credit would seem to exert the minimum added restraint--although in the case of M3 and total credit the actual restraint would be greater than indicated by

the 1/2 point reductions if the outcome for next year were near the midpoints of the ranges rather than in the upper halves, given actual growth over 1983.

There are special considerations with respect to M2, however. A 1/2 point reduction from last year's 7 to 10 percent range does not appear to be a "real" reduction since, as explained in the blue book, last year's range allowed leeway for something like 1/2 to 1 percent more on growth from the lingering impact of shifts related to the introduction of MMDAs and super-NOWs. A 6 to 9 percent range for M2 would thus seem to be more consistent with the restraint implicit in the ranges for M3 and total credit. The midpoint of that range is lower than assumed in the staff's GNP forecast--a forecast that allows for some acceleration of price increases in 1984 relative to 1983.

If the Committee wished to exert even greater restraint against the possibilities of added price pressures as the economic expansion proceeds, consideration could be given to a drop in the M2 range to 5-1/2 to 8-1/2 percent, as suggested in alternative I in the blue book. Consistency with such an approach would also appear to entail cutting back on the M1 range from the tentatively adopted 4 to 8 percent range--a 4 to 7 percent range is suggested. Unless upward wage and price pressures turn out to be less than currently projected by the staff, such an approach to policy seems more likely than, say, the tentatively adopted ranges, to involve a significant rise of interest rates, given the increases in velocity of M2 and M1 that would be implied next year at the midpoints of the ranges--2 percent in the case of M2 and 3-1/2 percent in the case of M1. The restraint generated may also hold back credit and GNP growth

from that currently projected, and a 7-1/2 to 10-1/2 percent range for credit might be considered in this context.

A three-point range for M1 was suggested in the more restrictive alternative partly because reducing the lower limit of the M1 range to below 4 percent might seem unrealistic. But a three-point range for M1--whether 4 to 7 or somewhat higher under the other alternatives--might also be considered should the Committee wish to indicate that more weight is being given to M1 in policy formulation and implementation. In that respect, the behavior of the velocity of M1 in recent quarters has been more in line with historical experience in the sense that a cyclical rebound in velocity, though a much muted one, has developed. Moreover, the period of greatest shifting of funds in response to the introduction of new MMDA and super-NOW accounts is well behind. These developments alone would seem to suggest that at least somewhat more weight could now be placed on M1.

However, even that hesitantly positive note about M1 might need some qualification. There are now about \$125 billion of NOW and related accounts in M1, of which about \$40 billion are super-NOW accounts. About 20 or 25 percent of all NOW accounts are estimated to represent funds that formerly were in savings accounts of one kind or another. Thus, these accounts may be more responsive to savings motives than M1 has been historically, as indeed may be the case for other NOW accounts whose holders may have become more sensitized to the availability of interest earning alternatives. Moreover, and perhaps more importantly, the behavior of M1 deposits probably will be influenced more than in the past by the interest rate strategies of depository institutions.

All of this means that we cannot be very certain about the interest-elasticity of demand for M1 since there has not been sufficient experience with an M1 with this mix of deposits. That is not a strong drawback in a period of little interest rates change--like a period such as we've had over the past year when the velocity of M1 has come to look more stable or predictable. On the other hand, should there come to be a period of significant interest rate change--such as might develop if the demands for goods and services were either a lot stronger or weaker than currently anticipated--it is possible that the demand for M1 and its velocity behavior would once again change noticeably. For instance the demand for M1 consistent with a given level of income could fall if rising market interest drew money out of the fixed ceiling rate NOW accounts and banks did not raise super-NOW interest rates sufficiently to retain the funds. Or demand for M1 could rise for a time consistent with a given level of income if falling market rates drove funds from outside M1 into fixed ceiling rate NOW accounts as market rates fell toward the ceiling rates.

I do not want to overstress these possibilities since banks are now in a better position--with the flexibility given by super-NOWs and MMDAs--to make adjustments to offering rates that might dampen the volatility of flows into and out of M1 as market rates change. But there is uncertainty in the outlook because we have only limited experience with bank and public reactions to changing market conditions in the new, deregulated era.